

Taxpayers' Rights Advocate's

2003-04

BUSINESS TAXES ANNUAL REPORT



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Second District

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Letter to the Executive Director

October 2004

Mr. Ramon Hirsig
Executive Director

Dear Mr. Hirsig:

I am pleased to present the Taxpayers' Rights Advocate's 2003-04 Business Taxes Annual Report. This report

- Highlights the accomplishments of the Taxpayers' Rights Advocate Office during the past year,
- Identifies current issues we are working to resolve, in tandem with agency management, and
- Identifies emerging issues we recommend for consideration in the coming year.

Problem resolution continues to be our primary focus. Although we saw a slight dip in the number of requests compared to last year, we expect that our contacts will grow in the coming years as a result of our increasing statewide visibility, as explained below.

One of our top priorities is to increase voluntary tax compliance and to avoid potential problems through improved public education and outreach. For example, we have partnered with the Advocate Offices of the Franchise Tax Board, the Employment Development Department, and the Internal Revenue Service to provide outreach at Taxpayer Service Days and Small Business Fairs and to provide seminars for enrolled agents and CPAs. We will continue to work collaboratively with those agencies to further our mission. We are also planning to meet with the district offices and with headquarters staff to provide follow-up education on how to approach our common responsibilities in ensuring the equitable and fair treatment of tax and fee payers.

We look forward to working with staff and the public at large as we identify trends and issues, develop viable solutions, and strive to better serve our customers.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "Todd C. Gilman", with a stylized, flowing script.

Todd C. Gilman
Taxpayers' Rights Advocate

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TAXPAYERS' RIGHTS ADVOCATE OFFICE

In January 1989, the original Taxpayers' Bill of Rights was established to ensure that the rights, privacy, and property of California taxpayers were adequately protected in the assessment and collection of sales and use taxes. Approximately 856,000 taxpayers are currently provided protection under this law.

Effective January 1993, the Special Taxes Bill of Rights was established expanding the Bill of Rights statutory authority to the special taxes programs administered by the Board of Equalization (Board), currently impacting approximately 183,000 tax and fee payers. Since these programs primarily affect business owners, they will be referred to generally as the Business Taxpayers' Bill of Rights, covering both sales and use taxes and the various special taxes and fees.

The Morgan Property Taxpayers' Bill of Rights was added in January 1994, governing the assessment, audit and collection of property taxes, with the goal of ensuring taxpayers receive fair and uniform treatment under the property taxation laws.

The Taxpayers' Rights Advocate (TRA) Office:

- facilitates resolution of taxpayer complaints or problems;
- monitors various Board tax and fee programs for compliance with the Taxpayers' Bill of Rights;
- recommends new procedures or revisions to existing policy to ensure fair and equitable treatment of taxpayers;
- participates in various task forces, committees, and public forums;
- holds mandated Taxpayer Bill of Rights hearings to provide the public with an opportunity to express their concerns, suggestions, and comments to the Board Members.

The TRA Office generally assists taxpayers who have been unable to resolve a matter through normal channels, when they want

information regarding procedures relating to a particular set of circumstances, or when there appear to be rights violations in either the audit or compliance areas. Taxpayers also call to convey their frustration, seeking assurance or confirmation that staff action is lawful and just.

The TRA Office provides assistance to taxpayers and Board staff to facilitate better communication between these parties and to eliminate potential misunderstandings. Taxpayers are provided information on policies and procedures so they can be better prepared to discuss and resolve their issues with staff.

When a customer or Board employee alleges discrimination or harassment, the TRA Office staff works with the Equal Employment Opportunity Office, Internal Security and Audit Division (ISAD), and program managers to resolve the complaint. Allegations of misconduct or threats by taxpayers or Board staff are referred to ISAD for investigation. Working together with program management, these offices support the Board's commitment to a discrimination/harassment-free taxpayer environment by investigating complaints and ensuring that Board staff are properly trained in these areas. Likewise, alleged taxpayer discrimination or sexual harassment toward Board staff is appropriately addressed.

In cases where the law, policy or procedures do not allow any change to the staff action, but a change to the law, policy or procedure appears justified, the TRA Office is alerted to a potential area that may need clarification or modification. Several of the past suggestions for *Taxpayer Information Bulletin* articles, recommendations for policy or procedural changes, suggestions for enhancements to staff training materials, and legislative proposals have resulted from these types of contacts with taxpayers.

ACCOMPLISHMENTS

The two primary functions of the TRA Office are to ensure fair and equitable treatment of taxpayers in the assessment and collection of taxes and to recommend changes in policies, procedures, and statutes to improve and/or ease taxpayer compliance.

As a result of specific contacts from taxpayers, issues raised at the annual Taxpayers' Bill of Rights (TBOR) hearings, and issues identified by the TRA Office, suggestions are presented to the program staff for evaluation. With the cooperation of Board staff, the following changes were accomplished this past year.

- **Modified Lien Procedures** — We have received contacts from concerned taxpayers regarding the filing of liens. When it is determined that a lien was filed against the wrong person, the lien is released. However, the taxpayer's credit history may be directly affected by the lien action. As mentioned in last year's TRA Office report, there appeared to be some inconsistency over responsibility and procedures for helping taxpayers correct the error on their credit reports. The responsibilities of district office staff and the Special Procedures Section have been clarified to help taxpayers correct the error on their credit reports. After receiving a memo with supporting documentation from district office staff, the Special Procedures Section will provide a notarized letter stating the person on the lien is not the Board's taxpayer, with instructions to provide the letter to credit reporting companies and others who may question the lien. This change has been implemented, and Compliance Policy and Procedures Manual (CPPM) section 763.090 was revised in May 2004 to reflect this change.
- **Changed Statute of Limitations for California Purchasers** — We have received contacts from anonymous taxpayers and representatives of anonymous taxpayers who have been acquiring untaxed merchandise from out-of-state retailers for a period of time and have not been remitting payment for their use tax liability. These contacts have suggested they would voluntarily come forward to register if the statute of limitation was three versus the current eight years of potential liability. Effective January 1, 2004, AB 1741 Chapter 697 shortens the statute of limitations from eight to three years with respect to use tax due from qualified California purchasers incurring use tax liabilities on purchases from out-of-state retailers. This bill also allows relief of penalty when a purchaser's failure to report the use tax liability is due to reasonable cause.

CURRENT ISSUES

The following issues are currently being reviewed with program management to develop solutions.

- **Modify Lien Policies that Affect Third Parties**

Under the policy established by the Board, staff can file a lien in a county in the name of the person or entity having an outstanding liability with the Board. Other persons, or third parties, that may have an interest in the property subject to the lien may be impacted by the placement of the lien in the county's record.

Third parties seeking release of the lien are normally required to make full payment in exchange for release of the lien. The demand is made without regard to the interest held in the property by the tax debtor.

The TRA Office along with the Offers in Compromise Section recommend changes that will take into account the debtor's contribution to equity — or lack thereof — in contemplation of issuing a partial release of lien. This would include special consideration for innocent spouses and ex-spouses who are not on the Board's lien but are affected by it. These proposed changes are consistent with Franchise Tax Board and Internal Revenue Service policies.

Administrative or legislative solutions need to be developed to allow the Board greater flexibility on these issues.

- **Liens on Discharged Liabilities** — Previously, the TRA Office identified several cases involving liens related to discharged liabilities. In the past, the Special Procedures Section required taxpayers to provide a certified or guaranteed property search to prove the taxpayer did not own property, or fraudulently transfer property, from the recording of the lien to the petition date of the bankruptcy.

Unfortunately, many taxpayers were reporting that they were unable to find a title company that would issue an insured guarantee. Because of current title com-

pany practices, the Special Procedures Section has agreed to accept a property search by a title company even if the search does not come with an insured guarantee. The tax lien would then be released. The TRA Office will work with other sections at the Board to educate staff on this change.

Due to the state's current fiscal situation, the Board has been unable to purchase additional searching service software that would allow the Board to perform the necessary title searches in-house.

The TRA Office intends to reintroduce this idea when the state's fiscal situation improves. In-house searches would minimize taxpayer complaints, reduce the compliance burden, demonstrate the Board's reasonableness, and maintain consistency with the intent of the Bankruptcy Code.

- **Relief from Penalty Requests** — Existing statute requires the assessment of penalties for taxpayers who fail to comply with the statutory requirements to remit taxes by Electronic Fund Transfer (EFT), file a return timely, and remit taxes timely.

Taxpayers who believe they could not comply with the law because of circumstances beyond their control can apply for relief from penalty through the Return Analysis Section (RAS) of the Return Analysis and Allocation Division. RAS staff reviews and considers the approval or denial of these taxpayer requests based on established criteria in accordance with the statutes.

If relief is not granted, the taxpayer may submit additional information and request to have the decision reconsidered by management. To appeal beyond this level, the taxpayer must pay the penalty, file a claim for refund, and go through the legal appeal process.

The TRA Office recommends that we change this process to allow for further appeal without requiring the taxpayer to pay the

penalty and file a claim for refund. The TRA Office will work with program departments to assess what changes are needed.

- **Centralize Updates for Accountant, Attorney, and Taxpayer Representatives** — Taxpayer representatives periodically contact the TRA Office regarding lack of notification to them. In addition, the representatives often do not know whom to contact when changes are required on their client's account. It was suggested that the Board have one centralized location to contact for these updates to the taxpayer's account or develop a systemized method to link account changes. Staff is currently researching this issue.
- **Out-of-State Corporations Applying for California Temporary Seller's Permits** — It has been brought to the TRA Office's attention that when an out-of-state corporation applied for a Temporary Seller's Permit, form BOE 400-MT, to operate as a business in California, the corporation was subject to an annual franchise tax for corporations. Without prior knowledge of this requirement, taxpayers were exposed to years of potential penalties and accrued interest. Although form BOE 400-MT has been discontinued, the TRA Office is working with Board staff to include this information in publication BOE 400-SPA, *California Seller's Permit Application for Individuals/Partnerships/Corporations/Organizations (Regular or Temporary)*.
- **Questionable Successors and Dual Determinations** — In certain circumstances, the law allows the Board to issue a determination (more commonly known as a bill) to an individual other than the registered holder of a seller's permit. For instance, in the case of a suspended or abandoned corporation, Revenue and Taxation Code section 6829 provides for the personal liability of a corporate officer under specified conditions. In addition, the Board may issue a determination against the purchaser of a business — the successor — when the predecessor fails to notify

the Board of a change in ownership and the successor does not obtain a tax clearance from the Board. In such circumstances, in order to protect the State's interests, staff may issue a "dual determination" against both the registered holder of a seller's permit and another party for an unpaid liability.

The TRA Office has noted a discrepancy in the handling of dual determinations depending on whether the liability arose due to audit findings or due to nonfiling or nonpayment of returns. Evidence should be established (purchase price, assumption of indebtedness, willfulness, etc.) to support successor and dual determinations. Generally, compliance staff provides the documentation to support these types of determinations. While the Board can legally require a taxpayer to pay the amount in full and request a refund, it does not seem equitable to follow this logic in all cases. For instance, when we bill a taxpayer as the result of an audit, the taxpayer is allowed to provide district staff with records or additional information that was not available while the audit was in process. This can be done even if a late protest is not accepted. In many cases, district audit staff will consider the evidence presented by the taxpayer and recommend an adjustment if it is warranted. This is not usually the case for liabilities not related to audits. The TRA Office is working with staff to provide consistent handling of these types of issues.

- **State Application and Information for Offers in Compromise (OIC)** — Practitioners and taxpayers have come to the California Advocates of the three state agencies (BOE, FTB, and EDD) and indicated their interest in filing one OIC application where they have a liability with two or more agencies. The OIC Managers and the California Advocates of the three state agencies are working together to develop options for consideration by management.

EMERGING ISSUES

As a result of taxpayer contacts and review of trends, policies, and procedures within the Board, the TRA Office recommends consideration of the following issues:

- **Returns Filed When Received on Compliance Assessments** — Returns filed subsequent to a compliance assessment for the same period may be treated differently depending on whether the returns are mailed directly to headquarters or to a district office. When tax returns are provided to collection staff in a district office, they are reviewed to determine if the taxpayer has reported correctly. The returns are then forwarded to headquarters for processing. However, in some instances, district staff will delay forwarding these returns while they seek additional information to determine the accuracy of the returns. By not forwarding the returns to headquarters shortly after receipt, the tracking and proper follow-up of the returns is not available to any level of staff. This can impact the assessment of penalties and interest and potentially the entire liability if bankruptcy discharge later occurs. The TRA Office would like to review current practices and work with staff to develop uniform treatment of returns.
- **Payment Proposal Renewal Letter** — Currently, staff is required to send form BOE-407-T, *Installment Payment Agreement - Notice of Termination* to the taxpayer prior to cancellation of an installment payment agreement. The TRA Office would like to explore the benefits of requiring staff to send form BOE-59, *Installment Payment Proposal – Renewal*, when staff reviews or changes an existing payment arrangement. This will help taxpayers understand what is required in order to continue on a payment agreement, as well as document the action taken by Board staff.
- **Liens or Levies on Non-Partners** — Some persons who have been granted nonpartner relief and no longer have an outstanding liability on the account have been issued liens or levies in error. Currently, these issues are addressed by releasing the lien and/or having the nonpartner file a claim for refund. The TRA Office would like to work with the appropriate section on current procedures to see what safeguards are in place to prevent liens or levies being issued in error.
- **Voluntary Payments Received after Taxpayer Files Bankruptcy Petition** — Some taxpayers continue making payments under a voluntary payment arrangement after they file bankruptcy. The TRA Office would like to work with staff to provide guidance concerning when these payments should be accepted or returned to the taxpayer or bankruptcy court.
- **Liens, Levies, or Billings on Liabilities Discharged in Bankruptcy** — The TRA Office has had several cases where taxpayers have been concerned because liens, levies, or billings have included periods that have been discharged in bankruptcy. In some cases, payments were incorrectly applied to discharged periods. The TRA Office would like staff to analyze current processing of accounts that have discharged liabilities to determine if automated safeguards are feasible.
- **Bad Mailing Address** — The TRA Office has had several cases where a bad mailing address has caused the taxpayer not to receive required notices and billings. Subsequent investigation has shown that the taxpayer provided a correct address to the Board, but the information was never updated on the Board's records. The TRA Office would like to review the policy and procedures for updating mailing addresses, look into the feasibility of placing a bad address flag on accounts known to have incorrect mailing addresses to alert staff to ask for updated information when in contact with the taxpayer, and explore options with staff to determine the best approach for educating staff on their responsibility to forward new address information for updating.

TAXPAYER CONTACTS WITH TRA OFFICE

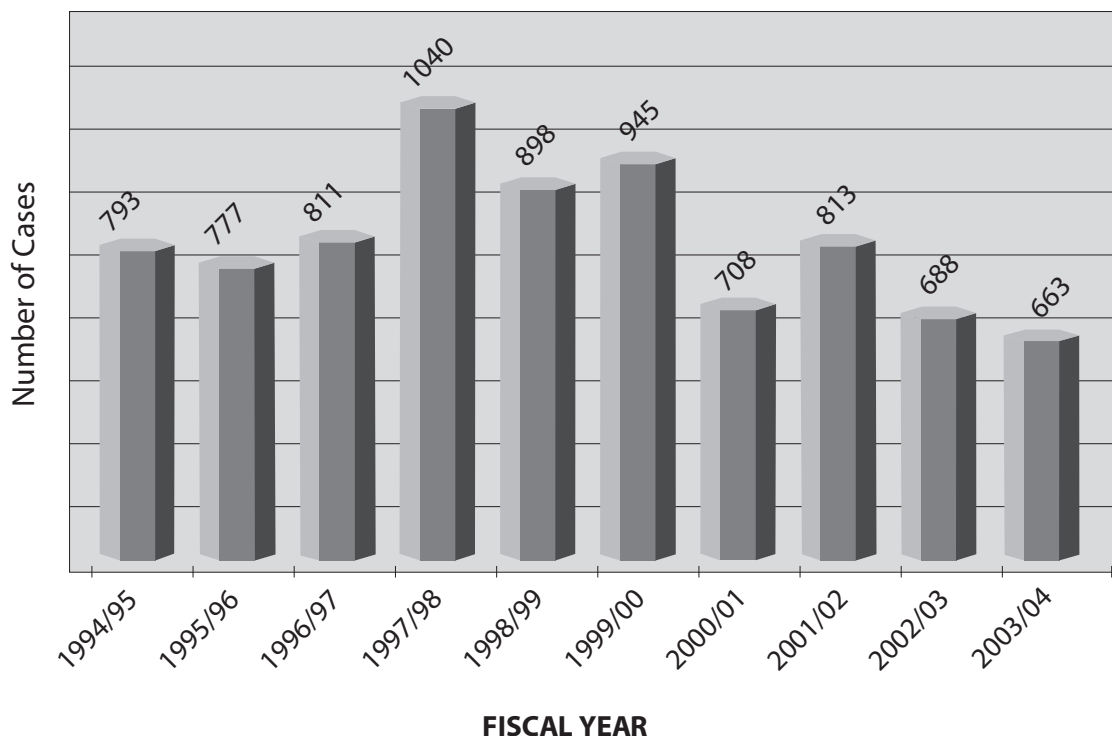
Historical Caseload

During Fiscal Year 2003-04, the TRA Office recorded 663 new business taxes cases, a slight reduction from last year. The staff shortage mentioned in the 2002-03 Annual Report continued in 2003-04. This shortage had two effects on the operations of the TRA Office. First, some taxpayers had to be referred to headquarters staff and/or district staff for initial review and resolution. For instance, during January through April of 2004, an average of 243 phone calls per month were referred instead of being set up as cases. The second effect was that the most urgent taxpayer problems were often being resolved without staff taking the time to formally set up and track the case, due to the backlog of cases to be worked. The primary focus under the circumstances was dealing with taxpayer complaints swiftly.

Appendices 1 and 2 provide a breakdown of contacts by district and headquarters offices. Cases were assigned to a specific district or headquarters office if the taxpayer contacted the TRA Office regarding an action taken by a specific office. Taxpayers who wanted general information and guidance regarding a Board process or procedure were assigned to the TRA Office as the office of origin.

When reviewing these appendices, it should be noted that there are many contributing factors that may cause certain districts to reflect a higher number of cases than other districts. For example, characteristics related to population, especially size, growth, and density of taxpayers within the district, the type and size of business operations, and geographic proximity to headquarters could all contribute to the disparity between districts.

TRA Historical Caseload Growth



Taxpayer Inquiries Cover a Wide Range of Issues

Of the 663 cases received, 66 percent involved compliance-related issues, 10 percent involved audit-related issues, and 24 percent involved other issues, such as consumer use tax exemptions, general information, and FTB matters.

During fiscal year 2003-04, the TRA Office tracked the reasons that taxpayers made contact and allowed for up to three reasons per contact in the statistics. The top 20 reasons are displayed in Appendix 3.

The most common reason taxpayers contacted the TRA Office was to obtain information and guidance on a particular process or to determine if an action taken by the Board staff was appropriate and in compliance with law and procedures. The remaining issues in descending order were: TRA Office intervention requested, questioning liability, levy or earning withhold order (EWO), lien, penalty, tax collection, audit procedures, payment plan, refund, account maintenance, appeals, consumer complaint, policy or procedure issue, interest, offers in compromise, reimbursement of levy fees, returns, security, and ownership/dual/successor issues.

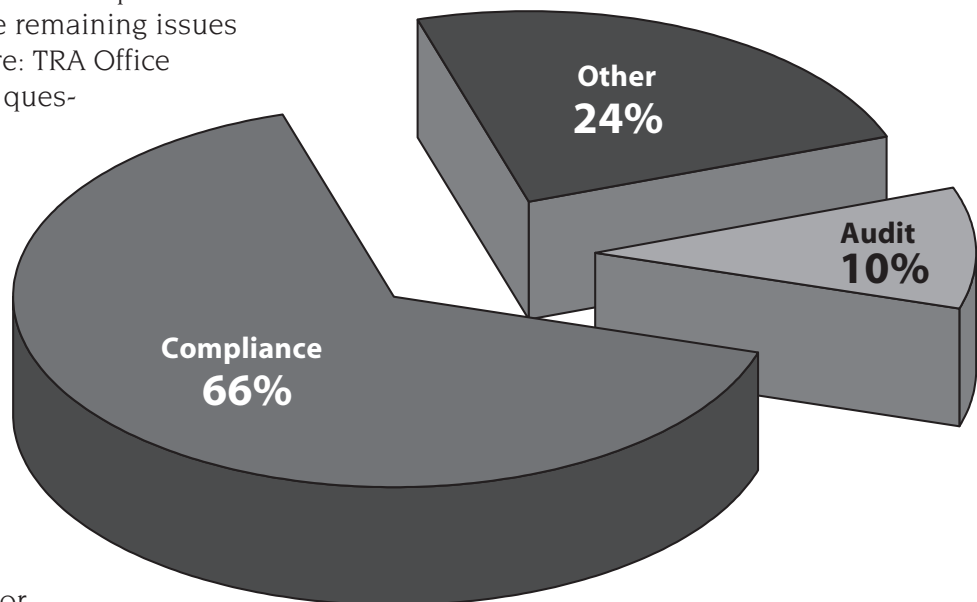
Customer service issues are divided into four broad categories:

1. *Communication*: misinformation, refusal to allow the taxpayer to talk to a supervisor, failure to answer specific taxpayer questions, or not receiving a communication or notice.
2. *Board delay*: slow response to inquiry, or delay in issuing refunds or resolving the taxpayer's case.

3. *Staff courtesy*: complaint about staff demeanor, manner of handling the taxpayer's case, or comments made by staff.
4. *Education*: lack of information regarding tax law, Board policy, or Board procedures; or staff training issues.

Approximately 18 percent of the total TRA Office contacts were customer service issues, the majority being communication issues. Although this is a significant increase from last year's 7 percent, the TRA Office believes that these statistics will decrease once the emerging issue concerning bad addresses is addressed.

Note: the customer service statistics were captured solely based on the taxpayers' statements or impressions of the situation; therefore, these statistics do not necessarily



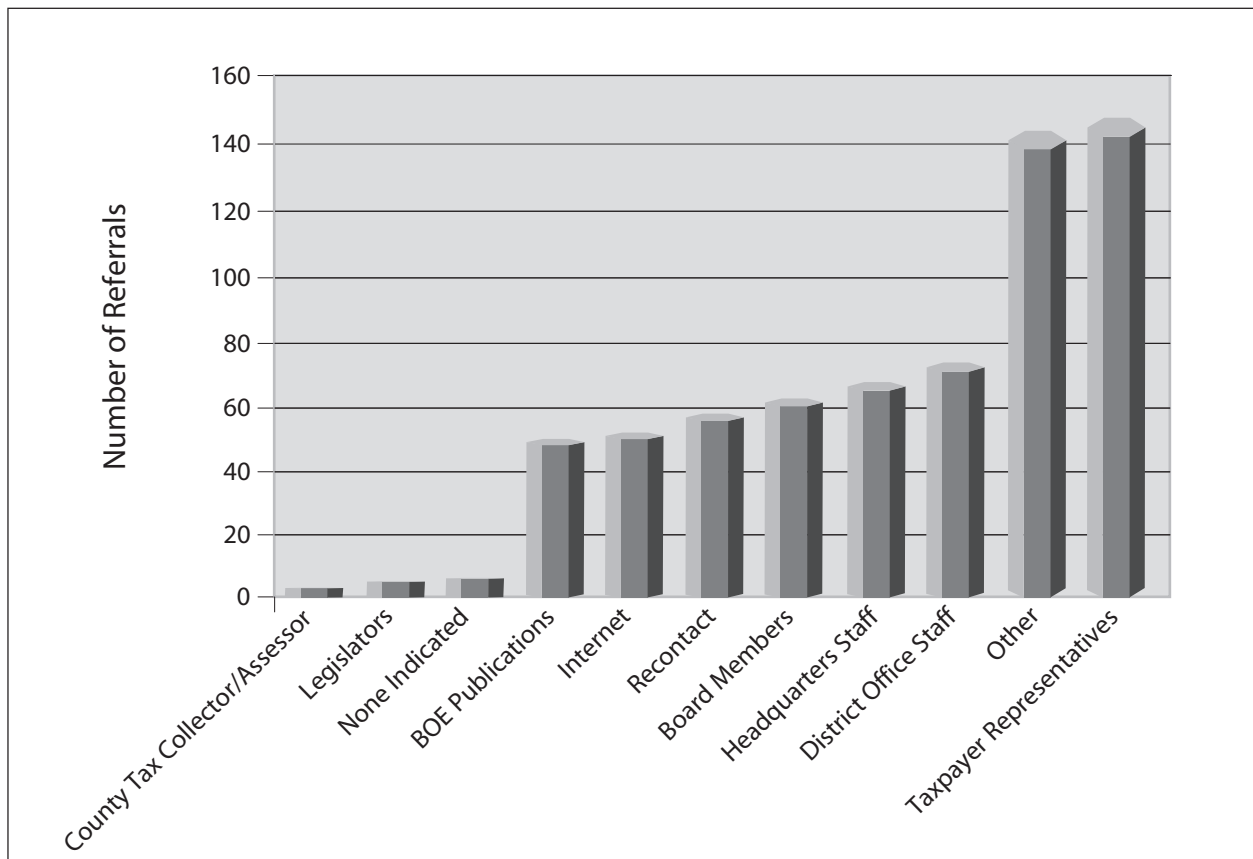
indicate verified problems but reflect the taxpayers' perception of the situation. For example, if a taxpayer states that collection staff made a rude comment, a "staff courtesy" complaint would be recorded. However, frequently the taxpayer's contention did not match staff's recollection of the situation or was portrayed from a different perspective.

How Taxpayers Were Referred to the Advocate Office

In an effort to improve our service to the public, the TRA Office attempts to identify the source of referrals. Taxpayer representatives referred the majority of taxpayers, reflecting 22 percent of the total referrals and a 30 percent increase from last year. The TRA Office attributes this increase to focussed

outreach at seminars for enrolled agents and CPAs. It is interesting to note that referrals from district office staff decreased 35 percent from last year. The TRA Office attributes this decrease to curtailment of TRA Office presentations to district staff in recent years because of funding constraints.

The following chart reflects the breakdown of how taxpayers were referred to our office.



APPENDIX I

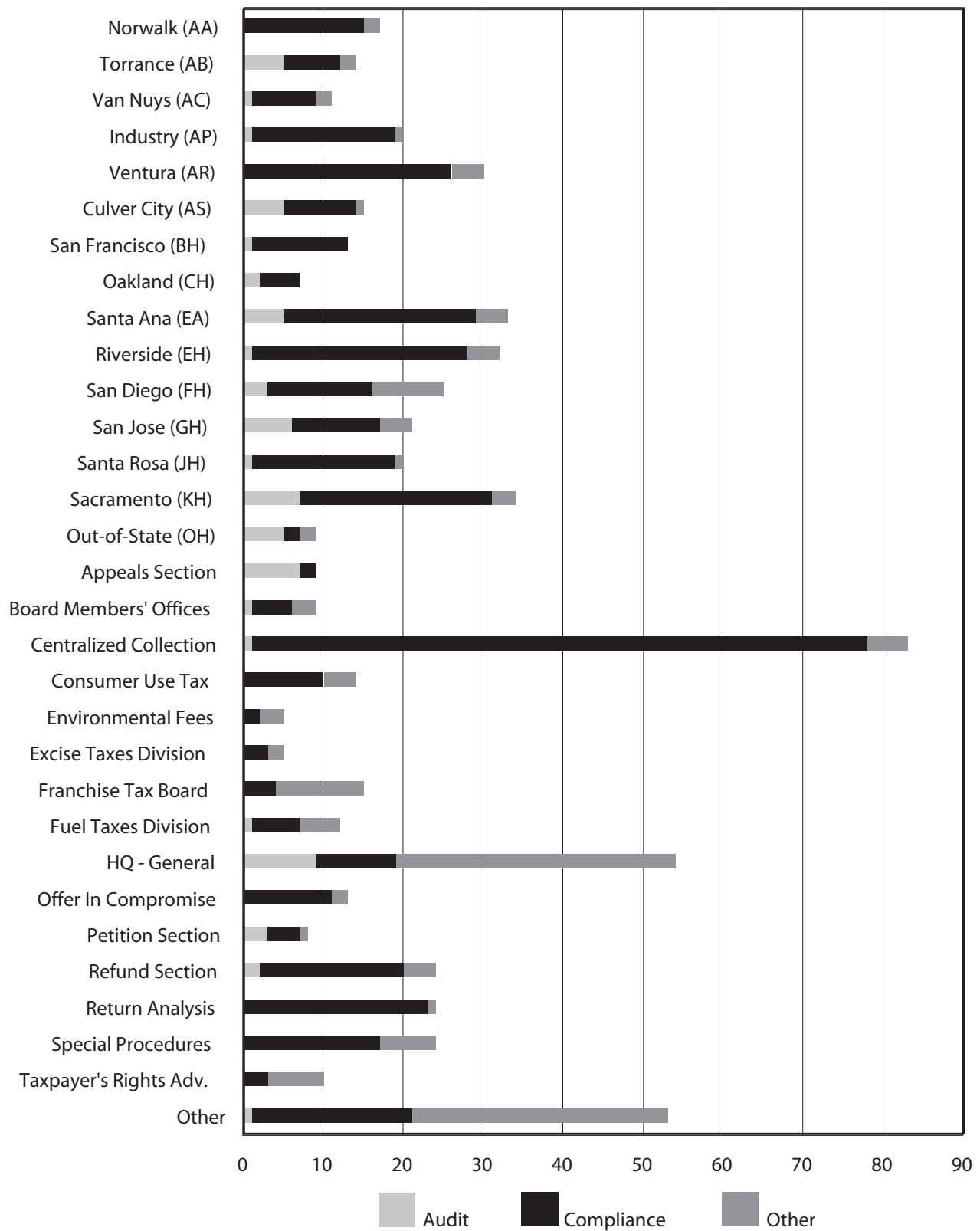
TAXPAYERS' RIGHTS ADVOCATE OFFICE CASE SUMMARY (FY 2003-04)

Entity Working Case	Cases by Issue Type			Total Cases	Confirmed Staff Case Handling		Case Handling Changed		Satisfied with Outcome		Referred To		
	Audit	Compliance			Yes	No	Yes	No	Yes	No	District	HQ	Other
			Other										
Norwalk (AA)	0	15	2	17	3	1	2	3	7	0	8	4	1
Torrance (AB)	5	7	2	14	0	0	3	1	11	0	9	3	1
Van Nuys (AC)	1	8	2	11	2	2	3	0	6	1	8	1	1
Industry (AP)	1	18	1	20	4	0	1	4	14	0	16	3	0
Ventura (AR)	0	26	4	30	9	5	10	1	19	0	22	2	5
Culver City (AS)	5	9	1	15	6	0	3	1	13	0	13	2	0
San Francisco (BH)	1	12	0	13	3	2	4	1	8	0	10	1	0
Oakland (CH)	2	5	0	7	0	1	1	1	5	0	7	0	0
Santa Ana (EA)	5	24	4	33	6	5	10	4	23	0	25	2	0
Riverside (EH)	1	27	4	32	7	6	10	4	23	0	21	6	1
San Diego (FH)	3	13	9	25	4	3	4	3	16	0	21	1	1
San Jose (GH)	6	11	4	21	7	2	7	2	17	0	17	2	0
Santa Rosa (JH)	1	18	1	20	2	3	7	1	11	0	13	2	0
Sacramento (KH)	7	24	3	34	10	1	7	7	20	1	25	1	1
Out-of-State (OH)	5	2	2	9	1	0	1	0	6	0	4	1	3
Appeals Section	7	2	0	9	1	1	1	1	5	0	2	5	1
Board Members' Offices	1	5	3	9	2	0	0	2	3	0	1	4	3
Centralized Collection	1	77	5	83	11	7	14	4	41	1	16	44	4
Consumer Use Tax	0	10	4	14	2	1	2	0	8	0	0	10	1
Environmental Fees	0	2	3	5	0	1	1	0	3	0	0	4	1
Excise Taxes Division	0	3	2	5	2	0	0	0	4	0	1	4	0
Franchise Tax Board	0	4	11	15	0	1	0	1	12	0	0	0	15
Fuels Taxes Division	1	6	5	12	2	0	1	1	8	1	0	10	0
HQ—General	9	10	35	54	10	2	1	9	25	2	2	44	5
Offer In Compromise	0	11	2	13	2	0	1	3	4	1	2	8	1
Petition Section	3	4	1	8	1	0	1	0	1	0	0	7	0
Refund Section	2	18	4	24	3	2	3	2	14	0	0	15	0
Return Analysis	0	23	1	24	11	4	4	11	12	0	1	23	0
Special Procedures	0	17	7	24	2	6	9	0	16	0	2	16	2
Taxpayer's Rights Adv.	0	3	7	10	1	0	0	1	6	0	2	2	4
Other	1	20	32	53	1	2	2	3	36	1	7	21	13
Total	68	434	161	663	115	58	113	71	397	8	255	248	64

Note: The columns "Confirmed Staff Case Handling," "Case Handling Changed," "Satisfied with Outcome" and "Referred To" will not always equal the total cases since they are not applicable in all cases.

APPENDIX 2

TAXPAYER CONTACTS BY BUSINESS TAXES OFFICE



REASONS TRA OFFICE WAS CONTACTED IN 2003-2004

